SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1944

No. 188

ALBERT E. McKENZIE AS TRUSTEE IN BANKRUPTCY OF GRAVES-QUINN CORP,

Petitioner,

vs.

IRVING TRUST COMPANY.

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK AND BRIEF IN SUPPORT THEREOF.

M. CARL LEVINE,
DAVID MORGULAS,
Counsel for Petitioner.

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against

IRVING TRUST COMPANY,

Respondent.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable, Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Your petitioner, Albert E. McKenzie as Trustee in Bankruptcy of the Graves-Quinn Corp. respectfully submits this petition for a writ of certiorari to review the decision of the Court of Appeals of the State of New York, 292 N. Y. 347 which affirms the final judgment of the Apellate Division of the Supreme Court of the State of New York, First Department and the final judgment entered thereon in the Supreme Court of the State of New York in the office of the Clerk of the County of New York under date of April 19th, 1944.

History of the Case.

This action was originally brought by the Petitioner predicated on two causes of action (R. 35). The first cause of action sought to set aside a transfer of $150,000 made by the bankrupt to the respondent as being preferential within the meaning of Section 60-a of the Bankruptcy Act. The second cause of action sought to nullify the transfer on the ground that it was void within the meaning of Section 15 of the Stock Corporation Law of the State of New York. Subsequently and prior to the judgment of the Court of Appeals of the State of New York, the second cause of action was severed by order of the Supreme Court of the State of New York, so that the instant action might proceed as if only the first cause of action were present and the judgment final (R. 87). We will accordingly proceed to a discussion of the history of the proceedings herein on the assumption that the action concerns itself *ab initio* only with the first cause of action.

After issue had been joined, respondent moved for summary judgment in accordance with Section 113 of the Rules of Civil Practice of the State of New York (R. 4) on the ground that as a matter of law the alleged transfer had occurred more than four months prior to the filing of the bankruptcy petition.

The respondent's motion for judgment was originally heard at a Special Term of the Supreme Court of the State of New York, and the motion denied, on the ground that the alleged preference did occur within the four-month period. The opinion is not officially reported and is found at R. 78 to 82.

The respondent then appealed to the Appellate Division of the Supreme Court of the State of New York (R. 2) wherein the order of the Special Term was reversed (R. 88) and judgment rendered for the respondent dismissing

the complaint (R. 89). The opinion of the Appellate Division is found at R. 91 to 94 and is published in the Official New York State Reports at 266 A. D. 599.

Your petitioner thereupon appealed to the Court of Appeals of the State of New York (R. 85) and the judgment of the Appellate Division was unanimously affirmed. The opinion of the Court of Appeals is appended to the Record. It has been published in the Official Reports of the State of New York, 292 N. Y. 347.

The Court of Appeals is the highest Court of the State of New York to which any appeal could be taken and the judgment of affirmance will remain final, unless jurisdiction is taken by this Court.

Summary Statement of Matter Involved.

In September of 1940, the Bankrupt entered into a contract with the United States for the construction of military housing facilities at a price of $1,008,800. The Standard Accident & Insurance Company delivered its performance and payment bond to the Government and simultaneously therewith and under date of October 2nd received an assignment from the Bankrupt of all funds to become due from the Government (R. 74). On October 24th, 1940 the contractor borrowed $40,000 for a 10-day period, the Bank expecting repayment within a week (R. 49). On November 15th, 1940 the contractor was indebted to the respondent for about $85,000 (R. 50). At this point it clearly appeared that the contractor was in financial difficulty and the respondent feared that if work stopped, the surety company might step in and complete the construction and at the same time obtain all payments from the Government. In order, therefore, to lend an appearance of normalcy, the respondent continued to lend the contractor more money with the intent of seizing the next

payment to become due from the Government before the surety's attention could be drawn to the contractor's financial difficulties. The respondent's officers then started a series of discussions as to how they might best extricate themselves from their precarious situation (R. 51).

Toward the end of November, 1940 the Government was considering a substantial progress payment to the Contractor. At that time many of the subcontractors were unpaid (R. 73-74). The respondent's officers knew full well that the surety company might at that moment step in and take over the job under its right of subrogation and receive all Government payments (R. 51). The Bank had real reason to fear that it might lose its loans. In an effort to circumvent this, the Bank under date of November 22nd, 1940, obtained from the Bankrupt an assignment of all moneys under the contract, but withheld filing it with the Secretary of War for his approval, or giving the surety notice, as required by the Federal Assignment of Claims Act. This was not because of ignorance, but was deliberate, inasmuch as the Bank knew filing was essential to the validity of the assignment. (R. 55). The concealment had for its objective the acquirement of the Government payment before the surety or the creditors were made aware of the contractor's precarious position. (R. 51).

On November 27th, 1940, the contractor received in Boston, Massachusetts, a Government check in the sum of $155,865.50, and at about 10 P. M. of the same day mailed the check to the respondent bank for deposit in the account of the contractor, and at the same time, and in the same mail, enclosed a check to the order of respondent bank in the sum of $150,000 in repayment of certain outstanding loans, $110,000 of which had matured, $40,000 of which was not due until December 9th, 1940. It is conceded that the records of the Bank indicate that on November 28th the

Government check was deposited in the bankrupt's account and that on November 28th the sum of $150,000 was withdrawn from the contractor's account in payment of its obligations to the respondent bank. This was only after the bankrupt had delivered its check for $150,000 to the order of the respondent. The bankrupt's notes were then cancelled and marked paid on November 28th. (Photostatic Exhibits R. 76 et seq.)

After the respondent had cancelled the outstanding loan of $150,000 on November 28th, it then notified the contractor that no loans would be made on the assignment unless the surety subordinated its rights to those of the respondent as regards all subsequent payments from the Government (R. 52-53).

The assignment was not filed with the four agencies as required by the Federal Assignment of Claims Act until December 4th, 1940 and was not approved by the Secretary of War until December 5th, 1940 (R. 22). The petition in bankruptcy was filed on March 28th, 1942 *exactly four months within the date of the repayment of the $150,000 to the respondent bank.*

Accordingly an action was commenced by the Trustee in Bankruptcy to set aside the payment of $150,000 made on November 28th, 1940 on the ground that it was made within four months of the filing of the petition in bankruptcy and preferential within the meaning of Section 60-a of the Bankruptcy Act.

The Bank thereupon moved for judgment dismissing the complaint on the ground that the transfer had not occurred within the four month period (R. 66; 71). The respondent in effect claimed that it had a right to the moneys as of November 22nd, the date it received the assignment.

The Trustee contended that assignments of moneys due under a Federal contract were void as against a Trustee in Bankruptcy, unless the assignment had been filed and approved as provided by the Assignment of Claims Act, more than four months prior to bankruptcy. Also the Trustee contended that the doctrine of "relation back" or "equitable assignment" could not be invoked in order to give the assignment validity as of the date of its delivery without the four month period if the statutory requisites as to filing had not been complied with until a date within the four month period. The Court of Appeals held that the assignment effected an inchoate transfer and that if the filing statute was subsequently complied with—the assignment acquired a retroactive finality on the theory of "relation back."

Jurisdiction of This Court to Grant Certiorari.

Jurisdiction of this Court to review the aforesaid judgment is granted by Section 237(b) of the Judicial Code, 28 U. S. C. 344(b).

The decision sought to be reviewed was rendered by the Court of Appeals of the State of New York, the highest Court of that State.

The decision concerned itself almost solely with Federal Statutes and the opinions of this Court construing Federal Statutes.

This application is made within the three months allowed by 28 U.S.C. 350. The order of the Court of Appeals was rendered April 13th, 1944. In conformity with the Civil Practice Act of New York, the judgment of the Court of Appeals was made the judgment of the Supreme Court of the State of New York on April 19th, 1944.

Statutes Involved.

The Federal Statutes involved will be found in the appendix. They are:

1. Sec. 3477 of the Revised Statutes, 31 U.S.C. 203 as amended by Assignment of Claims Act October 9th, 1940.

2. Section 60-a of the Bankruptcy Act as amended, 11 U.S.C. 96.

Questions Presented.

(a) As against a Trustee in Bankruptcy is an assignment of moneys to become due under a Federal contract null and void under the rules laid down by this Court in *National Bank of Commerce* v. *Downie*, 218 U. S. 345, unless and until the said assignment be filed and approved as provided by the Assignment of Claims Act, *Corn Exchange National Bank* v. *Klauder*, 318 U. S. 434.

(b) Did the decision of this Court in *Martin* v. *National Surety Co.*, 300 U. S. 588, overrule *National Bank of Commerce* v. *Downie*, 218 U. S. 345, wherein it was held that an assignment of Federal funds was void as against a Trustee in Bankruptcy who seeks to set aside the assignment as preferential.

(c) Where a Trustee in Bankruptcy seeks to set aside an assignment of Federal moneys as preferential within the meaning of Section 60-a of the Bankruptcy Act, does the four months period begin to run as of the date of the execution and delivery of the assignment, or as of the date the assignment was filed and approved as provided for by the Assignment of Claims Act.

(d) Did the Court of Appeals of the State of New York in effect refuse to recognize the holding of this Court in

Corn Exchange National Bank v. *Klauder*, 318 U. S. 434, that the doctrine of "relation back" was repudiated by the amendments to the Bankruptcy Act effective in 1938, when the said Court of Appeals held that where an assignment was subsequently filed and approved as provided for in the Assignment of Claims Act its effectiveness related back to the date of its execution and delivery.

(e) Did the Court of Appeals properly apply the test of what constitutes a perfected transfer of Federal moneys within the meaning of Section 60-a of the Bankruptcy Act and as construed by this Court in *Corn Exchange National Bank* v. *Klauder*, 318 U. S. 434.

Reasons for Granting Petition.

The Court of Appeals has passed on most important Federal questions of substance affecting rights under the "Assignment of Claims Act," being amendment to 31 U. S. C. 203, and Section 60-a of the Bankruptcy Act. The Court of Appeals has held that although an assignment of moneys to become due under a Federal contract may be invalid unless filed, nevertheless, once filed, the assignment has retroactive validity as of the date of its delivery, and that this is so against a Trustee in Bankruptcy. In so holding, the Court of Appeals invoked both the doctrine of "relation back" and "inchoate assignments" both of which were expressly repudiated by this Court in *Corn Exchange National Bank* v. *Klauder*, 318 U. S. 434. To make the conflict still more inexplicable, the Court of Appeals cited *Corn Exchange National Bank* v. *Klauder* (*supra*) in support of its decision.

The Court of Appeals improperly held that no bonafide purchaser or creditor could acquire superior rights in the property assigned between the date of the execution of the assignment and the date of filing, as provided for by the Assignment of Claims Act.

The Court of Appeals failed to give recognition to the fact that the Bankrupt could make no valid assignment in view of a prior assignment to the Surety for the bankrupt, although similar assignments to sureties have been recognized by this Court in *Martin* v. *National Surety*, 300 U. S. 588, as superior to subsequent assignees.

The holding of the Court of Appeals is in direct conflict with the opinion of this Court in *National Bank of Commerce* v. *Downie*, 218 U. S. 345.

The questions presented are of widespread importance to Banks, Contractors, Surety Companies and Bankruptcy Trustees throughout the country. In the last few years, due to large number of government construction contracts and defaults arising therefrom, many serious questions have arisen as to the effect of the Assignment of Claims Act of October 9th, 1940, on assignments of Government funds and the respective rights of Sureties, Banking Institutions and Creditors.

As matters now stand the opinion of the Court of Appeals is the only opinion on the question to which one may look for guidance. It is significant that although the Court of Appeals affirmed the Appellate Division, it did not agree with its opinion and entirely disregarded that part which held filing wholly unnecessary. Thus, as matters now stand, there seems to be disagreement even between the Appellate Courts of New York although they have both come to the same result.

Summary Statement of Matters Involved.

This case presents:

(1) The refusal of the Court of Appeals of the State of New York to grant the remedies provided for by Section 60-a of the Bankruptcy Act and as the same have been recently construed by this Court in *Corn Exchange National Bank* v. *Klauder*, 318 U. S. 434.

(2) The refusal of the Court of Appeals of the State of New York to properly construe the rights and obligations arising out of the Assignment of Claims Act enacted October 9th, 1940, amending Section 3477 of the Revised Statutes, 31 U. S. C. A. Section 203.

(3) The refusal of the Court of Appeals of the State of New York to properly apply the law pertaining to rights flowing from unfiled assignments where statutes provide for filing and notice and the rights of a Trustee in Bankruptcy as enunciated by this Court in *Corn Exchange National Bank* v. *Klauder*, 318 U. S. 434.

(4) The refusal of the Court of Appeals to follow the opinion of this Court in *Corn Exchange National Bank* v. *Klauder* (supra) that failure to record an assignment where there is a statutory requirement to record renders the transfer ineffective as against a Trustee in Bankruptcy until the assignment is actually filed and the rights of the assignee are to be judged as of the date of filing.

Conclusion.

Wherefore, petitioner respectfully prays that a writ of certiorari may be issued out and under the seal of this Court directed to the Court of Appeals of the State of New York to the end that the judgment of the Court of Appeals may be reviewed and reversed, and for such other and further relief as may be just and proper.

Dated: ——

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521 Fifth Avenue,
New York City.

David Morgulas,
Of Counsel.

APPENDIX.

Statutes Involved.

R. S. 3477, Sec. 203, Title 31, U. S. C. Money and Finance.

All transfers and assignments made of any claim upon the United States * * * and all powers of attorney, orders, or other authorities for receiving payment of any such claim—shall be absolutely null and void, unless they are fully made—after the allowance of such a claim, the ascertainment of the amount due, and the issuing of a warrant for the payment thereof.

Amendment to Section 3477, Revised Statutes (October 9, 1940)

(Public No. 811, 76th Congress.)

(Chapter 779, 3d Session.)

(H. R. 10464.)

An Act.

To assist in the National Defense Program by Amending Sections 3477 and 3737 of the Revised Statutes to Permit the Assignment of Claims Under Public Contracts.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That sections 3477 and 3737 of the Revised Statutes be amended by adding at the end of each such section the following new paragraph:

"The provisions of the preceding paragraph shall not apply in any case in which the moneys due or to become due from the United States or from any agency or department thereof, under a contract providing for payments aggregating $1,000 or more, are assigned to a bank, trust company, or other financing institution, including any Federal lending agency: PROVIDED,

"1. That in the case of any contract entered into prior to the date of approval of the Assignment of Claims Act of

1940, no claim shall be assigned without the consent of the head of the department or agency concerned;

"2. That in the case of any contract entered into after the date of approval of the Assignment of Claims Act of 1940, no claim shall be assigned if it arises under a contract which forbids such assignment;

"3. That unless otherwise expressly permitted by such contract any such assignment shall cover all amounts payable under such contract and not already paid, shall not be made to more than one party, and shall not be subject to further assignment, except that any such assignment may be made to one party as agent or trustee for two or more parties participating in such financing;

"4. That in the event of any such assignment, the assignee thereof shall file written notice of the assignment together with a true copy of the instrument of assignment with

"(a) the General Accounting Office,

"(b) the contracting officer or the head of his department or agency,

"(c) the surety or sureties upon the bond or bonds, if any, in connection with such contract, and

"(d) the disbursing officer, if any, designated in such contract to make payment.

Notwithstanding any law to the contrary governing the validity of assignments, any assignment pursuant to the Assignment of Claims Act of 1940 shall constitute a valid assignment for all purposes."

Any contract entered into by the War Department or the Navy Department may provide that payments to an assignee of any claim arising under such contract shall not be subject to reduction or set-off, and if it is so provided in such contract, such payments shall not be subject to reduction or set-off for any indebtedness of the assignor to the United States arising independently of such contract.

Sec. 2. This Act may be cited as the "Assignment of Claims Act of 1940".

Approved, October 9, 1940.

Section 60-a of the Bankruptcy Act as amended by the Chandler Act of June 22nd, 1938, 52 Stats. 840, 869-870; 11 U. S. C. Sec. 96-a.

§ 60. PREFERRED CREDITORS.—a. A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition in bankruptcy, or of the original petition under chapter X, XI, XII or XIII of this Act, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class. For the purposes of subdivisions a and b of this section, a transfer shall be deemed to have been made at the time when it became so far perfected that no bona-fide purchaser from the debtor and no creditor could thereafter have acquired any rights in the property so transferred superior to the rights of the transferee therein, and, if such transfer is not so perfected prior to the filing of the petition in bankruptcy or of the original petition under chapter X, XI, XII or XIII of this Act, it shall be deemed to have been made immediately before bankruptcy.

SUPREME COURT OF THE UNITED STATES

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No. 188

ALBERT E. McKENZIE, AS TRUSTEE IN BANKRUPTCY OF GRAVES-QUINN CORP.,

Petitioner,

against

IRVING TRUST COMPANY,

Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

POINT I.

Until the Respondent Complied with Section 3477 of the Revised Statutes as Amended October 9th, 1940, the Assignment Was Null and Void.

The Court of Appeals held that the statute does not in express terms declare that an assignment is wholly void until it has been filed and consent given. In so holding the Court committed serious error. Prior to October 9th, 1940, assignment of claims against the United States were *absolutely null and void* in accordance with the express statutory language of Section 3477 of the Revised Statutes (31 U. S. C. A. Sec. 203).

The section was amended under date of October 9th, 1940 (Public Law 811 of the 76th Congress). The amendment is set forth in full in the appendix. It clearly states that as to contracts executed prior to the date of its enactment, (the contract in suit being executed September 14th, 1940), assignments may be taken out of the realm of nullity provided certain conditions are complied with, viz:

1. The assignment must be filed with the consent of the Head of the Department concerned.

2. The assignee shall file written notice thereof and file a true copy thereof in various Governmental offices, plus *the surety on the contractor's bond.*

Thus, it was not only the evident purpose of the amendment to provide certain exceptional circumstances where an assignment might be given validity but in requiring notice to the surety it was the evident purpose of the amendment to strike down any secret assignments.

Up to the time the respondent complied with the amendment of October 9th, 1940, its right must of necessity be judged under the old statute. The rule in bankruptcy, with respect to assignments of the instant character under the old statute was specifically stated by this Court in *National Bank of Commerce* v. *Downie*, 218 U. S. 345 to be that such an assignment was void as against a Trustee in Bankruptcy who sought to set it aside as preferential. That case is a specific authority that as between the assignee and Trustee in Bankruptcy the assignment is absolutely null and void. The Court of Appeals apparently disregarded the *Downie* case evidently on the assumption that its force was dissipated by the opinion of this Court in *Martin* v. *National Surety Company*, 300 U. S. 588.

We respectfully submit that although the *Martin* case liberalizes the rule under the special circumstances there

present, it did not involve bankruptcy principles and this Court specifically pointed out that it did not intend to overrule the *Downie* case.

In this connection, we might point out that the only Federal decision attempting to reconcile the aforesaid two opinions of this Court is *In Re Meadow Sweet Farms*; 32 Fed. Supp. 119 decided in the District Court for the Western District of New York, wherein the Court said:

> "The assignments did not comply with the provisions of Section 203, Title 31, U. S. C. A., which section prescribes requirements for valid assignments of claims against the United States. The claims were not allowed by the government when the assignments were made and warrants did not issue thereon until after the adjudication in bankruptcy.
>
> The evidence fairly establishes that the assignments were made for a present consideration and that no preference was created. The decision here turns on the interpretation of the statute regarding assignments (supra). The Supreme Court held in National Bank v. Downie, 218 U. S. 345, 31 S. Ct. 89, 54 L. Ed. 1065, 20 Ann. Cas. 1116, where the controversy as to the right to the fund was, as here, between a trustee in bankruptcy and a prior assignee, that assignments not in accordance with the statute were null and void. In Martin v. National Surety Company, 300 U. S. 588, 57 S. Ct. 531, 81 L. Ed. 822, the Court announced a more liberal view of the statute under other circumstances, but did not overrule the Downie case. I think the Downie case must control."

POINT II.

The Assignment Was Not Effective Until At Least December 2nd, 1940; Within the Meaning of Section 60-a of the Bankruptcy Act.

Corn Exchange National Bank v. *Klauder*, 318 U. S. 434.

In *Corn Exchange National Bank* v. *Klauder* (supra) this Court definitely held that failure to record rendered an assignment void against a Trustee and that the test of what constitutes a preferential transfer under Section 60-a of the Bankruptcy Act must be considered in light of the contemplated purpose of striking down secret liens.

It was the evident purpose of the amendment to the Assignment of Claims Act of October 9th, 1940, to not only compel filing, if any validity was to be given to the assignment, but further to give notice not only to various Governmental agencies but to the principal and largest potential creditor, to wit, the Surety Company. The Miller Act (40 U. S. C. 270) requires every contractor to furnish a surety company bond guaranteeing the payment of labor and materials, and as such the surety company always has a most vital interest in the disposition of any of the Government funds. In that capacity it represents practically all of the various creditors on the specific job because if failure occurs, it is the surety that is called on to pay and steps into the rights of practically all creditors.

That the respondent kept the assignment secret, although it knew that filing was required, is undisputed (R. 55). That the purpose of respondent's secrecy was to ward off suspicion of Surety and Creditors until respondent was repaid is also evident (R. 51). In *Corn Exchange National Bank* v. *Klauder*, 318 U. S. 434, this Court condemned such secrecy where notice was required only to the *debtor*. How much more applicable is the expressed purpose of Section

60-a of the Bankruptcy Act to strike down secret assignments where a Federal Statute not only requires filing but notice to the largest creditor—the Surety. Yet the Court of Appeals ignored the admonition of this Court in the *Klauder* case and condoned secret assignments by invocation of the repudiated doctrine of "relation back".

In applying the test, the Court of Appeals went completely astray IN HOLDING (292 N. Y. 347 at 358-9):

> "The appellant, however, fails to point out any rule whereby a bona-fide purchaser for value or a creditor could have any rights in the moneys which might become due under the contract before they were paid to the contractor or its assignee, except perhaps a lienor under the provisions of the Lien Law of this State".

We must then ask ourselves whether any bona-fide purchaser for value or any creditor could have any rights in the Government moneys before or after payment to the assignee.

Let us first apply the test as to the right of creditors against the respondent if bankruptcy occurred prior to the receipt of the Government check. Every Federal authority that we have been able to find is directly to the effect that any creditor furnishing labor and materials as well as the surety company would have a right to the Government fund prior to and superior to the right of the assignee bank

American Surety Company v. *Westinghouse Electric Co.*, 296 U. S. 133;
Jenkins v. *National Surety Co.*, 277 U. S. 258;
Prairie State Bank v. *U. S.*, 164 U. S. 227.

Even if the assignee actually received the money and the same were traceable that superior right would still exist.

Martin v. *National Surety Company*, 300 U. S. 588;
Cox v. *New England Equitable Insurance Co.*, 247 Fed. 955.

Neither the respondent bank nor any one else ever contended that a bona-fide purchaser who took an assignment and obtained the consent of the War Department, and advanced moneys thereon, would not have a superior right to the respondent bank with its unfiled assignment given for a past consideration. The right of a bona-fide purchaser as against a prior assignee of a Government claim where filing was provided for was expressly upheld in

Judson v. *Corcoran*, 58 U. S. (Howard) 612.

It was there most directly held that a second assignee who gives notice to the Government, where notice is permitted, and thereafter collects, is entitled to the fund as against the first assignee. It is also highly significant that the *Judson* case was cited with approval in *Salem* v. *Manufacturers Finance Co.*, 264 U. S. 182, urged by respondent and cited by the Court below.

The Court of Appeals relied on *Salem Trust Company* v. *Manufacturers Finance Company*, 264 U. S. 182 (where no filing statute and only a simple assignment was involved), for the proposition that filing of the assignment at bar was unnecessary. The Salem opinion clearly indicates that it is limited to the rights of successive assignees where no notice to the debtor is required or permitted by statute. The Court below also completely overlooked the essential distinction that the cited case had nothing to do with the question as to when an assignment might be deemed to be perfected within the meaning of the Bankruptcy Laws. That express distinction was pointed out in *Corn Exchange National Bank* v. *Klauder* (supra), wherein this Court said in footnote 8 to its opinion:

> "The decision in Salem Trust Co. v. Manufacturers' Finance Co., 264 U. S. 182, that, as a matter of 'general law', absence of notice to the debtor of the assignment

of his account did not open the door to a subsequent assignee to obtain superior rights was not rendered in a bankruptcy case and is in any event inapplicable since the decision in the Tompkins case."

POINT III.

The Doctrine of "Relation Back" Was Specifically Repudiated by This Court in Corn Exchange National Bank v. Klauder, 318 U. S. 434.

The Court of Appeals held that the delivery of the assignment before filing created an inchoate transfer of the assigned rights, and that once filed the assignment was given validity as of its original date of delivery. This holding is directly contrary to the letter and spirit of Section 60a of the Bankruptcy Act and to the holding of this Court in *Corn Exchange National Bank* v. *Klauder*, 318 U. S. 434.

We need go no further to indicate the error of that position than the footnote No. 11 to this Court's opinion in *Corn Exchange National Bank* v. *Klauder* (supra), viz.:

> "See statement of Professor McLaughlin, Hearings, Revision of the Bankruptcy Act, House Judiciary Committee, 75th Cong., 1st Sess., pp. 122-125. He stated Thompson v. Fairbanks, 196 U. S. 516, as applying a rule of state law that a mortgagee by taking possession of the mortgaged property at a time subsequent to the execution of the mortgage thereby validated it as of the time of execution. He said that Sec. 60(a) would prevent such validation by relation back. Similar disapproving reference was made to Bailey v. Baker Ice Machine Co., 239 U. S. 268; Carey v. Donohue, 240 U. S. 430; and Martin v. Commercial National Bank, 245 U. S. 513; with the explanation that 'You are going to have taken away some advantages that some people have enjoyed, and certain practices are going to be altered to some extent. But you have that every time you pass any kind of a commercial law'."

In commenting on the effect of the *Klauder* case on the doctrine of "relation back" the note in Collier on Bankruptcy, 14th Ed. Supplement (1943), 60.38, page 895, note 24 is most instructive:

> "The doctrine of 'relation back' a device which permitted many a secret lien to escape the effects of Section 60 prior to the 1938 Act is dead."

It is highly significant that even the respondent conceded in the Court below that in the absence of the filing of the assignment and the consent by the Secretary of War, it would have no right under the assignment. It attempts to accomplish the right under the assignment *ab initio* on the theory of "relation back" and the Court of Appeals put its stamp of approval on that theory directly contrary to the decision of this Court in *Corn Exchange National Bank* v. *Klauder* (*supra*).

The Court below stated that when the contractor received the check on November 27th it was in good faith bound to deliver the same to the respondent in accordance with the executed assignment. That erroneously presupposes that the assignment was valid for nowhere else can the source of any legal liability be directed. In so holding the Court of Appeals entirely misconceived the purport of Section 60-a of the Bankruptcy Act, for under that Section the Trustee could have intervened on November 27th and prevented the payment. At that time there was no such perfected assignment as would prevent the Trustee from acquiring a superior right. It is entirely immaterial what would have been the respective obligations as between assignor and assignee, if no one else had a right to intervene, but to say that the contractor was bound to deliver the check to respondent bank on November 27th is to beg the very question involved, which is: Could a Trustee in Bankruptcy have prevented such a transfer on November

27th, or could the surety company, *a creditor*, which had a prior assignment, have prevented a transfer on that day; or could a bona-fide purchaser have acquired a superior right? The Court below entirely overlooked the fact that on November 27th the surety company was actually a creditor, and that in effect, the moneys in question belonged to it, unless its rights were affected by actual compliance with the Assignment of Claims Act. It further completely disregarded the potentiality that a bona-fide purchaser could have acquired a superior right.

Point IV.

On November 22nd the Bankrupt, Having Previously Assigned to the Standard Accident & Surety Company, Had No Power to Make An Assignment to the Respondent, and at Least Until the Respondent Complied With Filing Requirements, the Surety's Rights Were Superior under the Doctrine of Martin v. National Surety, 300 U. S. 588.

Let us for the moment assume respondent's contention that no filing was necessary. Still respondent must fail for there was a prior valid assignment which would bar respondent's claim of title to the money, because on plaintiff's own theory, the bankrupt, having first parted with title, had nothing to assign. We refer to the prior assignment to the Standard Accident Insurance Company.

The fact is, that on October 2nd, 1940, seven weeks prior to the respondent's assignment, the bankrupt had already made an assignment of the same funds to the Standard Accident Insurance Company (217). It was the usual assignment contained in the indemnity agreement given by a contractor to his surety upon the issuance and delivery of a performance and payment bond. We deal here with an assignment identical to that which this Court recognized in *Martin* v. *National Surety* (supra) as creating rights and

equities superior to those of a subsequent assignee to whom the Government actually paid the contract balance. It has been repeatedly held that the surety company's rights are paramount, and date as of the date of the original indemnity and assignment agreement. In *Barnett* v. *Maryland Casualty*, 134 F. (2d) 725 (certiorari denied 320 U. S. 740), the Court, in characterizing a similar assignment to a surety, said:

> "The assignment involved here is from its terms a present assignment and not a mere promise to assign in the future."

Thus, in our case, a prior assignment having been made to the surety on October 2nd, 1940, and the surety being a creditor, the Court of Appeals was in error in holding that the assignment to respondent on November 22nd, 1940, per se, gave it exclusive and unquestioned right to the fund superior to any other creditor.

The record is clear that the contractor had failed to pay its bills long prior to November 22nd, 1940. This was a default within the meaning of the indemnity agreement, and the assignment was effective under the doctrine of the *Barnett* case (supra), at least by November 22nd, if not as of the date of the indemnity agreement (September 14th, 1940).

The Court below entirely misconceived the effect of the assignment to the surety company, stating, at the conclusion of its opinion, that it would give no heed to the alleged rights of the surety, inasmuch as the Trustee in Bankruptcy had no authority to bring an action to establish a superior title in some other person. *This evaded the very purpose of the petitioner in urging the assignment to the surety company. Our evident purpose was to show that the surety company was a creditor, and that under Section 60-a of*

the Bankruptcy Act could have intervened and demanded the moneys at all times and even have traced the fund directly into the hands of the Bank, unless its rights had been cut off when the Bank complied with the Assignment of Claims Act. Certainly the surety was a creditor within the meaning of Section 60-a of the Bankruptcy Act. As a matter of fact, the very Assignment of Claims Act provided that notice must be given to the surety, for it was the evident purpose of the Act to prevent secret assignments against the interest of sureties. Had the surety known of the assignment prior to the actual receipt of the moneys by the Bank, it needs little argument to realize that the surety would have caused a petition in bankruptcy to have been immediately filed, in order to prevent the unlawful diversion of $150,000. Under Section 60-a of the Bankruptcy Act the Trustee has the right to assume the position of every conceivable creditor, whose rights become those of the Trustee.

Point V.

The Assignment in Question, Involving a Contract and Warrant of the United States, Federal Law and Not State Law, was Applicable.

It is difficult to understand whether the Court of Appeals applied the standards of State or Federal law. In *Corn Exchange National Bank & Trust Co. v. Klauder*, 318 U. S. 434, this Court construed an assignment of moneys purportedly made in accordance with Pennsylvania statutes. In determining the effect of lack of notice of the assignment under the Pennsylvania statutes, this Court held that the standards which applicable State law would enforce against a purchaser for value must be applied. Seizing upon that phrase, the Court of Appeals

applied the State law test to the assignment of Federal moneys at bar, stating (292 N. Y. 347 at 358):

> "The 'standards which applicable State law would enforce against a purchaser for value' or against a creditor must be applied here. (Corn Exchange National Bank & Trust Co. v. Klauder, 318 U. S. 434.)"

The Court was in error. It should have applied the tests of Federal law, inasmuch as both a Federal statute and Federal moneys were involved.

Clearfield Trust Co. v. *United States*, 318 U. S. 363.

It would be an entirely different matter if Federal statutes did not require filing, and if Federal funds were not directly involved and their disbursement regulated by Federal statute.

POINT VI.

The Court Committed Serious Error in Disregarding the Book Entries of the Bank under Date of November 28th.

There was no question but that the bankrupt mailed the Government check to the respondent bank for deposit in the bankrupt's account, and that the moneys were so deposited on November 28th, exactly four months within the filing of the petition in bankruptcy. It is also undisputed that the bank withdrew $150,000 from the bankrupt's account on November 28th, in payment of its outstanding loans.

For some inexplicable reason, the Court below determined in its opinion that these transactions were to be disregarded, for the most fantastic reason, that they "merely constitute a record of the transaction in compliance with the directions of the contractor." Thus, instead of adhering to the record, the Court invoked the fiction that when the bankrupt actually received the check on November 27th, it held the same on behalf of the Bank by reason of the

assignment. Thus the Court below disregarded the actual and undisputed facts. The Court below completely disregarded that which was actually done in attempting to uphold the right of the Bank by reason of the assignment. The language of the Court in *In re National Lumber Co.*, 212 Fed. 928, at page 929, is most pertinent:

> "The parties chose to pay and to accept the money in the ordinary course of events, and their conduct is to be judged by what they did, not by what they might have done. Bank v. Campbell, 81 U. S. (14 Wall.) 87, 20 L. Ed. 832."

Irrespective of the effective date of the assignment it is our contention that the actual preference took place on November 28th. It is conceded that on November 27th the Bankrupt received in Boston the Government check payable to its order for $155,865.50, and late that evening mailed it to the respondent bank for deposit *in the Bankrupt's account*. It is undisputed that on November 28th the Bank actually deposited this check for $155,865.50 in the bankrupt's account, and that on the same day it accepted the check of the bankrupt drawn to the order of the respondent bank in the sum of $150,000, and on November 28th withdrew that amount from the bankrupt's account and cancelled four promissory notes of the bankrupt totalling $150,000.

If the respondent had acted on the assignment, and regarded the Government check as its property, it would not have deposited the Government check to the bankrupt's credit and account, and then gone through the additional step of having the bankrupt make out a check for $150,000 to the respondent's order so that the respondent might cancel $150,000 of the outstanding notes of the bankrupt; $100,000 of which were payable on demand, and $50,000 not due until December 9th (228). The moment the Government check was deposited in the bankrupt's account, the

money belonged to the bankrupt—a debtor and creditor relationship had already arisen. No matter what previous claim the Bank had to the Government check, it had relinquished it. On November 28th the proceeds were in the bankrupt's name, and it was obviously necessary for the Bankrupt to take some affirmative step to dispose of the $150,000. That is why the Bankrupt issued its check.

If what the respondent contends were actually in the contemplation of the respondent, it never would have deposited the Government's check in the Bankrupt's account. The fact is that the Bank knew on November 22nd, the date it received the assignment, that it could not become effective until the Bank obtained the consent of the Secretary of War (164).

While it is our contention that the fact of the deposit of the check in the Bankrupt's account and the subsequent payment on November 28th, are conclusive as to the date of the payment, thus rendering a consideration as to the date of the effectiveness of the assignment immaterial, we, nevertheless, contend that in no event could the assignment be given legal effect within the meaning of the Bankruptcy Act until the respondent complied with the Assignment of Claims Act of October 9th, 1940, both as to filing and approval of the Secretary of War.

Respectfully submitted,

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